Podgorica, 30 June 2025

Information on the review of the countercyclical capital buffer rate carried out in Q2 2025

The countercyclical buffer rate of 1% that is to be applied as of 1 January 2026 is prescribed under the Decision on Raising the Countercyclical Capital Buffer Rate (Official Gazette of Montenegro 27/24 and 125/24) and it remains appropriate for maintaining the resilience of the banking system against potential materialization of systemic risks or sudden shocks. Pursuant to the aforesaid decision, the countercyclical buffer rate of 0.5% is to be applied from 1 April 2025 until 1 January 2026.

Below are the key findings of the countercyclical buffer rate review carried out in the second quarter of 2025.

The starting point was the calculation of the buffer guide. The buffer guide was calculated using the so-called standardised credit-to-GDP gap in line with the Law on Credit Institutions and the Recommendation of the European Systemic Risk Board on guidance for setting countercyclical buffer rates (ESRB/2014/1).

At the end of the first quarter of 2025, the credit-to-GDP ratio stood at 51.6%. Compared to its long-term trend, this is a deviation of -5.2 pp, which is below the lower threshold of 2 pp, i.e. the minimum value that would indicate the need to introduce a non-zero countercyclical buffer rate, so the value of the buffer guide was 0%. In the first couple of years following the coronavirus pandemic outbreak, the credit-to-GDP ratio was particularly pronounced, showing negative deviations from the longstanding trend as a result of a stronger growth of GDP over credits. However, as of end-2023, the gap has been narrowing as a result of intense credit activity.

In addition to the buffer guide, the analysis includes other selected indicators that the Central Bank uses to monitor cyclical systemic risks in Montenegro, which signal a continued elevated accumulation of cyclical risks, primarily those related to credit growth and rising real estate prices.

During the first quarter of 2025, the annual growth rate for loans disbursed to residents remained at a high level, standing at 14.7% in March. The growth was driven by the rise in retail loans, which increased by 18.7% year-on-year, partly due to the rise in nominal wages in the previous period. The non-financial sector also recorded a significant annual credit growth of 19.1%.

As for retail loans, growth was primarily driven by cash and housing loans, which accounted for approximately three-quarters of all retail loans. The annual growth rate of cash loans amounted to 13.1% in March this year (as per the Credit Registry records). Additionally, both the number of loan agreements and the average amount of cash loans increased. Newly retail loans reached a new record high at the end of the first quarter of 2025, with cash loans accounting for the largest share of the new loans.

Retail housing loans recorded the annual rate of growth of 18.4% in March this year, and their cumulative increase since end-2020 reached 66.1% (Credit Registry data). Given their naturally longer maturity, the growth of retail housing loans has been noticed with new loans as well. Namely, their 12-month cumulative has been growing at an accelerated pace since 2022, with the annual growth of this cumulative reaching nearly 70% at the end of the first quarter of 2025. Housing loans reached a third of total retail loans and their growth has also been accompanied by an increase in the number of loan agreements and a higher average loan amount.

Apartment prices in new residential building in Montenegro recorded a significant annual increase in the first quarter of 2025 (22.9%), reaching a new historical peak of 2,158 euros per square meter. The growth of real estate prices in real terms (nominal prices adjusted for the consumer price index) was naturally less pronounced. The ratio of new apartment prices to average nominal wages showed no significant deviations. Overall, the evaluation indicates that real estate prices remain somewhat overvalued.

The leading factor spurring the growth of real estate prices was foreign direct investments in real estate, which amounted to 1.37 billion euros in the period 2022-2024 or 6.8% of the nominal GDP per year on average (113.5 million euros or 7.9% of GDP in Q1 2025), which is substantially more than over several years prior to this period. Besides foreign direct investments, the aforementioned increase in housing loans also affected the growth in real estate prices. In the period from 2022-2024, new housing loans amounted to 400.8 million euros, while in the first quarter of 2025 they totalled 48.8 million euros.

Real estate prices are important for the assessment of cyclical systemic risks because real estate is one of the most important forms of collateral used to secure both housing and mortgage loans. Unrealistically high real estate prices could amplify the upward phase of the financial cycle, driving loans to unjustifiable levels, yet in the phase of a possible sharp drop in real estate prices, they would negatively affect both debtors and bank balance sheets.

The banking sector has remained solvent, liquid and profitable. The steady year-on-year growth of deposits continued (despite a slight decline on a

quarterly basis in the first quarter of 2025), with banks increasingly redirecting these funds into loans rather than into liquid assets or securities. As a result, liquid assets have been mostly on a downtrend. On the other hand, it is important to consider the highly conservative definition of liquid assets established by the CBCG regulation governing liquidity risk management in credit institutions, as well as the fact that a significant portion of the securities held by banks remains highly tradable. Due to a significant lending activity, the loan to deposit ratio was on an increase since end-2022, reaching 86.3% gross and 83.9% net at end-Q1 2025.

The capital adequacy ratio stood at 20.1% and it has been a mild uptrend. Non-performing loans have declined, continuing this downward trend that has been present since early 2022. At the end of the first quarter of 2025, their share in total loans amounted to 3.2%.

The growth cycle of the weighted average lending interest rate (for the entire credit portfolio of banks, i.e. on outstanding principal/debt), which began in mid-2022, came to a halt in mid-2024 and has been on a slight decline ever since. The aforesaid interest rate amounted to 6.4% at the end of the first quarter this year.

During the first quarter of 2025, banks recorded a profit of 34.2 million euros, which is an 11.6% year-over-year decline (profitability reached a record high in Q1 2024), but this is still a significant profit.

International economic and other developments also play a role in assessing cyclical systemic risk, where tensions persist despite some signs of improvement.

Given the aforementioned factors related to credit growth, the real estate market, and global trends, the countercyclical buffer rate of 1% that is to be applied as of 1 January 2026, as specified in the Decision on Raising the Countercyclical Capital Buffer Rate (Official Gazette of Montenegro 27/24 and 125/24), remains appropriate considering the need to maintain the resilience of the banking system against potential materialization of systemic risks or sudden shocks. Pursuant to the aforesaid decision, the countercyclical buffer rate of 0.5% is to be applied from 1 April 2025 until 1 January 2026.

In accordance with its macroprudential responsibilities, the Central Bank of Montenegro will continue to regularly monitor potential imbalances in financing the needs of the non-financial sector and households, and publish the results of review of the countercyclical capital buffer rate on quarterly basis.